



NETWORK
GENERAL
CORPORATION

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ABOUT THE COMPANY

Network General Corporation is a leading supplier of software-based tools that help troubleshoot and maintain local area networks (LANs). The Sniffer family, Network General's line of user-friendly products, allows LAN managers to "look" into their networks, enabling them to monitor LAN activity, as well as diagnose and resolve problems more quickly and cost effectively.

The rapid growth of LANs in organizations of all sizes, their increasing complexity, and the mission-critical nature of LAN-based systems combine to create a significant need for troubleshooting and maintenance products.

As specialists in the business of LAN analysis, Network General believes it is well-positioned to provide tools for LANs of almost all prominent configurations or types, thus serving the needs of a wide variety of organizations.

FINANCIAL HIGHLIGHTS

(In thousands, except per share amounts and number of employees.)	1989	1988	Change
Net revenues	\$12,864	\$ 4,911	+162%
Net income	\$ 2,563	\$ 832	+208%
Net income per share	\$.51	\$.21	+143%
Total employees at year-end	39	15	+160%
Weighted average common and common equivalent shares outstanding	5,037	3,903	+29%

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LETTER TO STOCKHOLDERS

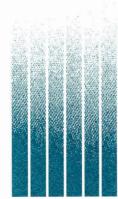
The nineteen eighty-nine fiscal year was an eventful one for Network General. As our financial highlights indicate, we saw revenues increase 162 percent over fiscal 1988 and net income increase 208 percent for the same period.

Perhaps the most exciting happening for our young company was the highly successful \$10.8 million initial public offering that took place this past February. Not only was our offering one of the first high-tech IPOs of the year, but it occurred at a time of great uncertainty in high technology capital markets. In spite of these uncertainties, however, we and our underwriters, Alex. Brown & Sons and Hambrecht & Quist, felt that Network General's inherent strengths boded well. In fact, our collective intuitions were borne out as the offering was many times oversubscribed.

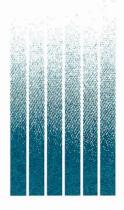
The performance of the stock over the past months has been impressive and, we hope, gratifying to our investors. More importantly, however, the offering has provided the funds needed to satisfy our currently projected working capital requirements.

A major part of this year's effort has been devoted to orderly management of our growth while maintaining efficient and streamlined operations. Our product development brought forth substantial new product advances as well as two significant software releases.

Our manufacturing capability has expanded significantly, allowing us to treble the production rate in the past year. We have maintained high levels of quality control, with a product return rate significantly less than one percent, while fulfilling customer orders in a timely fashion.







While our sales effort expanded in a number of key areas, our effectiveness in reaching the marketplace increased even faster. We hope to continue this progress in the current fiscal year: we will be instituting a telemarketing effort during the second quarter; we are working to develop ever more creative materials and programs to simplify the selling process; and, we will seek to enhance our affiliations with key LAN systems vendors through additional cooperative technical and joint marketing efforts.

Key to our selling strategy are profitable, committed manufacturers' representatives. To enhance these relationships, we've carefully crafted a support program that aims to garner share of mind for Network General's products. In fact, several of our largest U.S. sales representative organizations have already made firm commitments to Network General and, as a result, the Sniffer product line has become their number one source of revenue.

As we look forward to the year ahead, we are encouraged by the rapidly growing acceptance of the Sniffer family of analyzers across a broad spectrum of users. We have not hesitated to take the lead in setting the standard by which our competition is now measured, and we intend to continue to push the state of the art by challenging ourselves as well as others.

Sincerely,

Dr. Harry J. Saal *President*, CEO

CORPORATION

WHY IS LOCAL AREA NETWORKING SO IMPORTANT?

ocal area networking was developed as a means of allowing personal computer users to share essential information across an organization in a timely and cost effective way. LAN users can be given direct, "on-line" access to files and databases needed to complete a task. The results are increased productivity and the facilitation of communication among users of the network.

LAN technology also allows users to share expensive hardware resources such as laser printers or large file storage systems, thus making the adoption of these new systems more affordable.

Just as companies have come to depend upon centralized computer systems, they have become dependent upon LANs as an essential part of their computing environment.

WHY DO PEOPLE NEED LAN ANALYSIS TOOLS?

As the demand for network computing grows, so does the need for larger, more sophisticated LANs. Such LANs must be kept efficient as they grow larger and more complex. They must connect equipment from a growing list of vendors and run an assortment of applications programs from an equally broad array of suppliers. Single vendor systems are rapidly becoming a thing of the past.

Because of this increasing complexity and rapid growth, LANs have become harder to control, and are more likely to develop problems that are difficult to diagnose and resolve. These problems can slow throughput or cause total system failures. More importantly, they can cost users hours or days of productivity. When a large LAN goes down, the cost can run to thousands of dollars per hour. For the growing number of companies, such as airlines, that are totally dependent upon their networks for conducting business, the results of network downtime are even more staggering.

Network General's strategy is to serve the increasing needs of this rapidly growing market.

WHO IS USING LAN ANALYSIS TOOLS?

Network General's LAN analysis products are targeted to three major customer segments: LAN managers, LAN service personnel, and LAN product developers.

LAN MANAGERS.

Many companies with large networks employ one or more full-time professionals to manage the network. These LAN managers are responsible for operating, troubleshooting and growing the network.







LAN problems are difficult to diagnose since they originate from a variety of sources: intermittent outages on any of dozens, or hundreds, of individual nodes on the LAN; incompatibilities arising from diverse application software packages and inconsistencies in LAN operating system software; faulty boards or worn cabling somewhere on the network. Tracking down these complex events without proper equipment is not only time-consuming and inefficient, but can also fail to isolate the problem. Meanwhile, users can experience frustratingly slow LAN operation, or even total LAN failure. With the advent of LAN analysis tools, LAN managers are no longer forced to troubleshoot using time-consuming trial and error methods. What might have taken days or weeks to resolve can now be done in hours or minutes.

LAN SERVICE PERSONNEL.

Before tools such as Network General's Sniffer products came along, servicing a LAN involved a lot of guesswork since there was no powerful way of visualizing problems in the data being transmitted.



By working with the comprehensive picture of LAN activity that Sniffer products provide, network service personnel can quickly and precisely pinpoint the nature of a LAN problem. As a result, service people can be more efficient and productive.

Because Network General's analyzer products are housed in portable computers, they can be transported easily to customer sites.

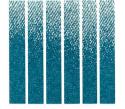
LAN PRODUCT DEVELOPERS.

For this class of users, Network General's Sniffer system can make a substantial difference. Network professionals developing new local area networks and associated software products have welcomed the technical sophistication of our products.

For LAN developers, the challenge is to develop and debug complex networking products before releasing them to the marketplace. They cannot do this easily without the ability to monitor these products as they actually perform critical network activities. Developers also need a tool which helps them determine how to "tune" their products to achieve optimum performance.

The Sniffer LAN analyzer provides these capabilities. The result is that developers can significantly improve their chances of getting a better product to market faster, and at less expense.

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WHAT SETS THE SNIFFER FAMILY APART FROM OTHER LAN ANALYZERS?

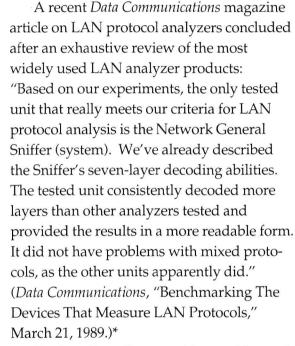
hen Network General began developing the Sniffer system, there were three major goals: first, to create a product that offered a comprehensive view of critical LAN activity; second, to make the system easy to use; and third, to make the Sniffer system configurable to allow users to troubleshoot the widest selection of LANs possible. With the Sniffer family of LAN analysis tools, Network General has met these goals.

A COMPREHENSIVE VIEW OF CRITICAL LAN ACTIVITY.

Perhaps the most important feature that sets the Sniffer product apart from the competition is that it offers the most complete view of LAN activity.

The Sniffer system fully decodes (in everyday English) all seven layers of the OSI (Open Systems Interconnection) Reference Model. This is important because each of the seven layers has its own distinct set of functions, implemented by network protocols, that may exhibit distinct problems. For example, layer three manages the routing of data between computers.

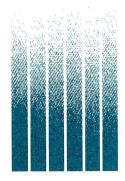
The analyzers offered by our major competitors fail to recognize and interpret all seven layers, thus overlooking critical symptoms in network problem-solving. While all competitive products may claim to be true LAN protocol analyzers, we believe that only the Sniffer family of products delivers this key capability.



By decoding all protocol layers, Network General's Sniffer analyzer has set the standard for LAN analysis tools.

FASY TO USE.

While the functions of the Sniffer analyzer are quite complex, Network General has taken great care to make it relatively easy for its users. Installation of a Sniffer system is as simple as connecting the unit to the network and turning it on. Its screens provide intuitive menus and easy-to-read English language displays. The decoding is complete, and the data is presented in a logical, understandable format. The system can be set to detect and decode any of a number of protocols in use on the LAN.



AVAILABLE FOR A BROAD SELECTION OF LAN VENDORS.

Since the first version in 1986, many new Sniffer products have been introduced that provide analysis for most of the LANs that play a significant role in the marketplace.

Currently, the Sniffer family provides support for the following LAN types: Ethernet, 4 Mbit and 16 Mbit IBM Token-Ring, StarLAN, ARCNET and IBM PC Network. Most competitive LAN analysis tools only support one or two LAN types.

In addition to LAN types, Sniffer analyzers recognize and decode a wide range of popular network protocols which include: TCP/IP, DECnet,™ Novell NetWare,™ XNS, IBM Token-Ring, Sun® NFS,™ ISO MS-NET, AppleTalk,™ X-Windows, and Banyan VINES.™

Features like these have earned industry awards for Sniffer LAN analyzers, including *PC Magazine*'s "Editor's Choice" in 1987, and "LAN Diagnostic Product Of The Year" by *LAN Magazine* in 1987 and 1988.

Unlike most of its competitors, Network General focuses primarily on the LAN analyzer market, and is not tied to any proprietary LAN product or manufacturer. The Company is, therefore, in a unique position to develop products specifically designed to meet the changing needs of a broad base of LAN customers that typically employ LANs having a diverse multi-vendor mix of hardware and software.

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STRATEGY FOR THE FUTURE.

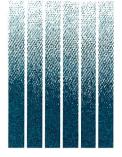


o describe the LAN industry as dynamic would be an understatement. Developers are introducing new applications all the time. Users are demanding more LAN features, easier connectivity, and more powerful applications. All this creates new complexities, as users' dependence on mission-critical LAN applications grows. To allow network users to take advantage of improvements in technology and applications, Network General will attempt to extend its current offerings and move swiftly to introduce new products.

In addition to its anticipated research and development effort, Network General will seek to maintain and develop cooperative relationships with networking industry leaders. The Company believes these relationships will help it support new developments in networking technology as quickly as they arise. During this past fiscal year, Network General announced joint development agreements with computing and networking companies such as Microsoft Corporation, Texas Instruments, Sytek, Inc., Plus Development Corporation, Banyan Systems, Inc., and Micro Technology, Inc.

Network General plans to focus its development efforts on products that will support additional connection technologies and protocols, permit LAN diagnostics from remote locations, and be even easier to use. As a leading developer of LAN analysis tools, Network General has achieved a strong position in this rapidly growing segment of the LAN marketplace.





FISCAL YEAR 1989 BUSINESS HIGHLIGHTS

March 7, 1989:

Network General is a highly focused company specializing in LAN analysis. For this reason, the Company has been able to announce several major new products in a relatively short amount of time. This year's achievements include the following:

June 1, 1988:	Network General introduces the first laptop analysis tools for Ethernet-based local area networks. Housed in a Toshiba T3200 portable computer, the system surpasses the competition in its combination of portability, diagnostic capability, speed, disk capacity and protocol level support.
August 2, 1988:	Network General introduces a network analyzer that supports Apple Computer's AppleTalk , one of the fastest growing network protocols. This analyzer serves the needs of the expanding multi-vendor environments which combine Apple, $DEC_{\circ}^{\mathbb{B}}$ IBM and others.
August 30, 1988:	Network General introduces a Sniffer protocol option to support the popular Banyan VINES $^{\circledR}$ network operating system.
September 20, 1988:	Network General announces several major extensions to the Sniffer product line, including the new Sniffer software version 2.0. New hardware platforms include a high-performance 80386-based portable system, a low cost, modular LAN analyzer, and a laptop analyzer that supports IBM's 4 Mbit Token-Ring. In addition, the Sniffer LAN analyzer exchange program is announced, enabling customers to upgrade their current Sniffer systems.
October 21, 1988:	In a joint agreement with Sytek, Inc., Network General announces new products that are compatible with Sytek's large installed base of broadband LANs for mixed media, multi-vendor environments. In addition, Sytek will resell Sniffer products as part of its network offerings.
November 21, 1988:	Network General announces the first protocol analyzer for 16 Mbit IEEE 802.5 Token-Ring LANs, providing an essential diagnostic tool for developers of next generation Token-Ring LANs.
December 6, 1988:	Expanding into European markets, Network General announces a three year agreement with Research Machines, Ltd. of Oxford, England, to develop a custom Sniffer product for the British firm's proprietary ZNet network.
January 24, 1989:	Network General teams with Plus Development to deliver the first removable media protocol analyzer for government and commercial network sites, targeting the security-sensitive LAN market.
January 31, 1989:	Network General announces the Laptop Sniffer Model PA-306, the industry's first portable protocol analyzer designed specifically for ARCNET® LANs.
January 31, 1989:	Network General announces an OEM licensing agreement with Micro Technology, Inc. to support the DEC networking environment.
February 21, 1989:	Network General and Network Computing Devices team up to offer Sniffer protocol analyzers for the X-Windows network protocols, which are used for high-resolution graphical display.

Network General unveils the Sniffer software version 2.1 update, which supports LANs using high

level ISO protocol software, and offers features to bolster network security.

CORPORATION

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Results of Operations

The Company has experienced substantial growth in revenues since product shipments began in September 1986. Results for successive quarters reflected the increasing market acceptance of the Company's products and expansion of the Company's marketing and sales efforts. Substantially all of the Company's revenues to date have been derived from the sale of LAN analysis products.

Fiscal 1988 revenues were approximately nine times fiscal 1987 revenues. Fiscal 1989 revenues were almost three times fiscal 1988 revenues. As a consequence, year to year comparisons of costs and expenses are not considered meaningful because of the vastly different levels of operations.

The following tables set forth certain quarterly financial information. This information is derived from unaudited financial statements which include, in the opinion of management, all normal, recurring adjustments which management

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June 30, Sept. 30, Dec. 31, March 31, June 30,

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considers necessary for a fair statement of the results for such periods. The operating results for any quarter are not necessarily indicative of results for any future period.

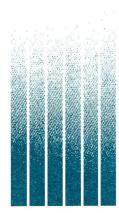
Over the past eight quarters ended March 31, 1989, sales of the Company's products have increased by over 459%. Sales for the quarter ended March 31, 1989, were 134% greater than sales for the quarter ended March 31, 1988. However, the Company does not expect to sustain these rates of growth in the future. Increases in sales from quarter to quarter have varied considerably, ranging from a low of 6% to a high of 90%, with sales for the Company's quarter ended March 31, 1989, representing a 19% increase over the immediately preceding quarter. Sales to international distributors accounted for 22% of revenues in fiscal 1988 and 15.5% of revenues for fiscal 1989.

Cost of revenues consists of manufacturing costs and warranty expenses. Gross profit varies from quarter to quarter due to factors including changes in the relative proportion of international and domestic sales, changes in product mix, new product introductions and price changes. During the six quarters ended September 30, 1988, gross profit varied from 76% to 79% of revenues, but in the quarters ended December 31, 1988 and March 31, 1989, gross profit declined to 74% of revenues. This decrease was due primarily to significant increases in sales of the Company's recently introduced Series 300 and 500 products combined with a significant decrease in sales of its older Series 400 products. Variability in quarterly revenue from OEM sales and the specific configuration of units shipped, i.e., number of protocol interpreters per network analyzer shipped, also affects quarterly gross profits. Gross profit may vary in future quarters due to the same factors as in the past, as well as to potential price reductions that could result from competitive pressures and to other factors.

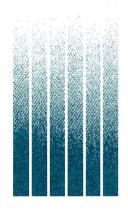
The Company's marketing and sales expenses have increased as a percentage of revenues over the last eight fiscal guarters, from 23% in the first guarter of fiscal 1988 to 31% and 30% in the third quarter and fourth quarter, respectively, of fiscal 1989. These increases are largely the result of significantly increased marketing expenditures, including those for advertising, collateral materials, trade shows, sales training and sales promotions, and increased compensation expenses due to expansion of the marketing and sales staff. Marketing and sales expenses as a percentage of revenues also reflect, in part, the mix of domestic and international sales, since the Company incurs higher sales commission expense on domestic sales.

The Company believes that continued commitment to research and development is required to remain competitive. Research and development expenses consist primarily of salaries and benefits, occupancy expenses and fees paid to outside consultants. Although expenditures for research and development over the past eight fiscal quarters have increased over 203%, research and development has declined as a percentage of revenues from 13% in the first quarter of fiscal 1988 to 7% in the fourth quarter of fiscal 1989 due to significant increases in revenues. While expenditures for salaries and benefits have increased throughout this period, variations in the utilization of consultants have resulted in fluctuations in the overall level of expenditures for research and development. The Company anticipates that salaries and benefits for research and development will continue to increase as permanent employees are hired.

Research and development expenses are accounted for in accordance with FASB Statement No. 86, under which the Company is required to capitalize software development costs after technological feasibility is established. Capitalizable software development costs incurred to



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date have not been significant and, thus, the Company has charged all software development costs to expense in the statements of operations.

The Company has been able to support its significant revenue increases during the past eight quarters of fiscal 1988 and 1989 without significantly increasing its level of general and administrative expenditures. As a result, general and administrative expenses have declined from 19% of revenues to 9% of revenues during that period. General and administrative expenses increased in the quarter ended March 31, 1989 due to an increase in the allowance for doubtful accounts and legal and accounting expenses related to the establishment of 401(K), employee stock purchase and employee stock option plans.

Net interest income has represented approximately one percent of revenues for the fiscal quarters following the private sale of approximately \$2.0 million of mandatorily redeemable convertible preferred stock in the third quarter of fiscal 1988. Earnings on the invested proceeds from the initial public offering of Common Stock have increased net interest income to four percent of revenues in the quarter ended March 31, 1989.

The Company accrued provisions for income taxes of 43% and 40% for fiscal 1988 and 1989, respectively. This decrease reflects the statutory decrease in federal income tax rates.

Liquidity and Capital Resources

The Company has financed its operations to date through cash flow from operations, the private sale of approximately \$2,000,000 of convertible preferred stock in fiscal 1988, and the proceeds of \$9,678,000, after expenses, from the recent initial public offering of Common Stock. The amount of the Company's capital commitments through fiscal 1989 is currently not material.

As of March 31, 1989, the Company's principal source of liquidity included cash and investments of approximately \$13.0 million. The Company currently has no borrowings and has no established bank lines of credit. The Company believes that the proceeds from the sale by the Company of the Common Stock in February, 1989, together with existing sources of liquidity and anticipated funds from operations, will satisfy the Company's projected working capital and capital expenditure requirements at least through fiscal 1990.





REPORT OF INDEPENDENT **PUBLIC ACCOUNTANTS**

To Network General Corporation:

We have audited the accompanying consolidated balance sheets of Network General Corporation (a Delaware corporation) and subsidiary as of March 31, 1989 and 1988, and the related consolidated statements of operations, stockholders' equity and cash flows for the years then ended and for the period from inception (May 15, 1986) to March 31, 1987. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Network General Corporation and subsidiary as of March 31, 1989 and 1988, and the results of their operations and their cash flows for the years then ended and for the period from inception (May 15, 1986) to March 31, 1987 in conformity with generally accepted accounting principles.

arthur andersen & Co.

San Jose, California April 21, 1989

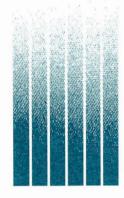


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CONSOLIDATED BALANCE SHEETS

MARCH 31, 1989 AND 1988
(Dollars in thousands except per share amounts)

(Dollars in thousands, except per share amounts)	1989	1988
ASSETS	1,0,	1700
CURRENT ASSETS:		
Cash and cash equivalents	\$ 1,456	\$1,379
Cash investments	11,551	1,500
Accounts receivable, net of allowance for doubtful		
accounts of \$98 and \$38 in 1989 and 1988, respective		1,037
Inventories	734	223
Prepaid expenses and deposits	70 252	14 120
Prepaid taxes and deferred tax assets		
Total current assets	16,190	4,273
PROPERTY AND EQUIPMENT, at cost:		
Demonstration and rental equipment	782	258
Office and development equipment	236	22
	1,018	280
Less Accumulated depreciation	(265)	(59)
	753	221
OTHER ASSETS	16	20
	\$16,959	\$4,514
HARMETER AND GEOGRAPH PERCENTAGE		
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:	\$ 497	\$ 286
Accounts payable Accrued liabilities	ъ 497 867	\$ 286 539
Income taxes payable	345	737
Customer deposits	103	48
Total current liabilities	1,812	1,610
LONG-TERM CUSTOMER DEPOSITS	77	75
SERIES A MANDATORILY REDEEMABLE		, ,
CONVERTIBLE PREFERRED STOCK—\$.01 par value,		
preference in liquidation of \$2,000		
Authorized—3,000,000 shares		
Outstanding—1,092,829 shares in 1988	=	1,968
COMMITMENTS (Note 4)		
STOCKHOLDERS' EQUITY:		
Preferred stock—\$.01 par value		
Authorized—1,907,171 shares		
Outstanding—none	-	-
Common stock—\$.01 par value		
Authorized—10,000,000 shares		
Outstanding—6,199,829 shares in 1989 and 3,754,000 shares in 1988	62	37
Additional paid-in capital	11,637	16
Retained earnings	3,371	808
Total stockholders' equity	15,070	861
	\$16,959	\$4,514
	ΨΙΟ,	ΨΙΟΙΤ

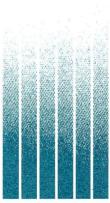


CONSOLIDATED STATEMENTS OF OPERATIONS

For the years ended March 31, 1989 and 1988 and for the period from inception (May 15, 1986) to March 31, 1987.

(Dollars in thousands, except per share amounts)	Year Ended March 31, 1989	Year Ended March 31, 1988	Inception (May 15, 1986) to March 31, 1987
REVENUES	\$12,864	\$4,911	\$ 556
COST OF REVENUES	3,084	1,128	160
Gross profit	9,780	3,783	396
OPERATING EXPENSES:			
Marketing and sales	3,910	1,302	66
Research and development	907	365	158
General and administrative	967	689	170
	5,784	2,356	394
Income from operations	3,996	1,427	2
INTEREST INCOME (EXPENSE), net	274	33	(2)
Income before provision for income taxo	es 4,270	1,460	-
PROVISION FOR INCOME TAXES	1,707	628	-
Net income	\$ 2,563	\$ 832	\$ -
EARNINGS PER SHARE	\$.51	\$.21	\$ -
WEIGHTED AVERAGE COMMON AND COMMON EQUIVALENT SHARES OUTSTANDING	5,037,000	3,903,000	3,276,000

The accompanying notes are an integral part of these consolidated financial statements.

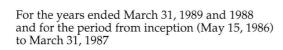




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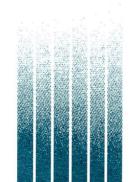
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY





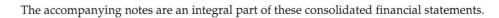
(Dollars in thousands, except per share amounts)	Commo Shares	n Stock Amount	Additional Paid-in Capital		Sale Retaine	
Sale of common stock at \$.0033 per share to founders	3,000,000	\$10	\$ -	\$ -	\$ -	\$ 10
Issuance of common stock at \$.0033 per share in exchange for notes receivable	579,000	2	-	(2)	-	-
Net income	-	-	-	-	-	-
BALANCE, MARCH 31, 1987	3,579,000	12	-	(2)	-	10
Change in par value to \$.01 per share upon reincorporation from California to Delaware	-	24	-	_	(24)	-
Exercise of stock options at \$.10 per share	175,000	1	16	-	-	17
Collections on notes receivable from sale of stock	-	-	-	2	-	2
Net income	-	-	-	-	832	832
BALANCE, MARCH 31, 1988	3,754,000	37	16	-	808	861
Initial public offering of common stock at \$8.00 per share, net of issuance costs of \$1,146	1,353,000	14	9,664	_	-	9,678
Conversion of mandatorily redeemable preferred stock into common stock	1,092,829	11	1,957	_	_	1,968
Net income	-		_	_	2,563	2,563
BALANCE, MARCH 31, 1989	6,199,829	\$62	\$11,637	\$ -	\$3,371	\$15,070

The accompanying notes are an integral part of these consolidated financial statements.



CONSOLIDATED STATEMENTS OF CASH FLOWS

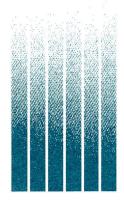
For the years ended March 31, 1989 and 1988 and for the period from inception (May 15, 1986) to March 31, 1987 (In thousands)	Year Ended March 31, 1989	Year Ended March 31, 1988	Inception (May 15, 1986) to March 31, 1987
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	\$2,563	\$ 832	\$ -
Adjustments to reconcile net income to net			
cash provided by operating activities-			
Depreciation and amortization	285	56	7
Provision for doubtful accounts	70	38	-
(Increase) decrease in assets-	(4.4.60)	(0 (3)	(0.1.0)
Accounts receivable	(1,160)	(863)	(212)
Inventories	(495)	(203)	(20)
Prepaid expense and deposits	(56)	(14)	.=
Prepaid taxes and deferred tax assets	(132)	(120)	(2E)
Other assets Increase (decrease) in liabilities-	2	1	(25)
Accounts payable and accrued liabilities	539	539	286
Income taxes payable	(392)	736	200
		17	26
Net cash provided by operating activities	1,224	1,002	36
CASH FLOWS FROM INVESTING ACTIVITIES:			
Proceeds from customer deposits	57	98	25
Purchase of property and equipment	(831)	(236)	(44)
Increase in cash investments	(10,051)	(1,500)	-
Net cash used in investing activities	(10,825)	(1,638)	(19)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from issuance of preferred stock	-	1,968	-
Proceeds from issuance of common stock,		1,500	
net of issuance costs	9,678	18	10
Proceeds from (repayment of) notes payable	953 / ULUMO 1155		
to officers	-	(20)	20
Collection on notes receivable from sale of stock	-	2	-
Net cash provided by financing activities	9,678	1,968	30
Net increase in cash and cash equivalents	77	1,332	47
CASH AND CASH EQUIVALENTS AT			
BEGINNING OF PERĨOD	1,379	47	-
CASH AND CASH EQUIVALENTS AT			
END OF PERIOD	\$1,456	\$1,379	\$ 47





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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 1989

1. OPERATIONS:

Network General Corporation (the "Company") designs, markets and supports software-based LAN analysis tools for a broad spectrum of physical connection technologies and communications protocols. The Company was incorporated in 1986 as a California corporation and changed its state of incorporation to Delaware in fiscal 1988.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiary, after elimination of intercompany accounts and transactions.

Revenues

The Company generally recognizes revenues upon shipment of the systems or software. Revenues on rental units are recognized ratably over the term of the rental period. Royalty income is recognized based on the number of copies of software sold by the licensees of the software products in the prior month. Revenues on software development contracts with certain OEM customers are recognized based on milestones specified in the contracts. Total revenues from rental units, royalties and software development contracts approximated \$943,000, \$230,000 and \$36,000 for fiscal 1989, 1988 and 1987, respectively.

No single customer accounted for more than 10% of revenues for fiscal 1989 or 1988. One customer accounted for 11% of total fiscal 1987 revenues. Export sales, mainly to Europe and Japan, accounted for 15.5% and 22% of revenues in 1989 and 1988, respectively. There were no export sales in 1987.

Cash and Cash Equivalents

For purposes of the statements of cash flows, the Company includes cash in banks and cash investments with a maturity of three months or less to be cash equivalents. Cash investments consist of Treasury Bills and certificates of deposit with maturities of greater than three months.

The Company paid approximately \$2,229,000 and \$12,000 in income taxes in fiscal 1989 and 1988, respectively (see Note 8). No taxes were paid in 1987. Amounts paid for interest were insignificant.

Inventories

Inventories are stated at the lower of cost (first-in, first-out) or market and include material, labor and related manufacturing overhead. Inventories consist of (in thousands):

	March 31,			
	1989	1988		
Purchased parts	\$598	\$101		
Work-in-process	124	122		
Finished goods	12	_		
	\$734	\$223		

Property and Equipment

Property and equipment are depreciated using the straight-line method over the following estimated useful lives:

Classification	Life
Demonstration and	
rental equipment	1-2 years
Office and development	-
equipment	3 years

In general, the Company requires the sales representative or customer to pay a refundable deposit against each demonstration or rental unit that is delivered. A certain percentage of rental payments can be applied towards the purchase of the unit.

Software Development Costs

The Company anticipates capitalizing eligible computer software development costs upon the establishment of tech-



nological feasibility, which the Company has defined as completion of a working model. As of March 31, 1989, such capitalizable costs were insignificant and, thus, the Company has charged all software development costs to expense in the accompanying statements of operations.

Earnings Per Share

Earnings per share is computed using the weighted average number of shares of common and common equivalent shares resulting from dilutive convertible preferred stock and options outstanding during the periods. Fully diluted earnings per share is the same as primary earnings per share.

3. ACCRUED LIABILITIES:

Accrued liabilities consist of the following (in thousands):

	March 31,	
	1989	1988
Accrued compensation		
and related taxes	\$278	\$197
Accrued commissions	437	228
Other accrued expenses	152	114
	\$867	\$539

4. COMMITMENTS:

The Company leases certain equipment under operating lease agreements with a company that is wholly owned by two officers and shareholders of the Company. Payments of approximately \$134,000, \$107,000 and \$28,000 were paid to this leasing company in fiscal 1989, 1988 and 1987, respectively. The Company also leases its facilities and certain other equipment under operating lease agreements. At March 31, 1989, minimum future lease payments under these operating leases are as follows (in thousands):

Fiscal Year		
1990	\$164	
1991	71	
1992	12	
1993	12	
1994	2	
	\$261	

Total rent expense was approximately \$285,000, \$127,000 and \$63,000 in fiscal 1989, 1988 and 1987, respectively.

5. CASH BONUS:

The Company has established a discretionary cash bonus plan for its employees. The amounts and individuals to be awarded the bonus are based on the achievement of certain performance goals for the Company and the individual, as approved by the Board of Directors. The Company recorded bonus expense of approximately \$427,000 and \$180,000 in fiscal 1989 and 1988, respectively.

6. EMPLOYEE SAVINGS PLAN:

In September 1988, the Board of Directors approved an employee savings plan (the "Plan") which is intended to be qualified and exempt from tax under section 401(K) of the Internal Revenue Code. Under the Plan, employees may elect to contribute up to 15% of their gross compensation. The Company contributes to the Plan in amounts determined at the discretion of the Board of Directors. All contributions by the Company are funded currently and vest ratably over three years. All employee contributions are fully vested. Amounts provided by the Company under the Plan to date have not been material.

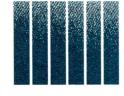
7. COMMON STOCK:

The Company consummated an initial public offering of its common stock at \$8.00 per share in February 1989. In connection with this offering, all mandatorily redeemable preferred stock outstanding at that time was converted into common stock on a one for one basis.

The Company has established the 1989 Stock Option Plan whereby key employees, employee directors and consultants may be granted either incentive or non-qualified options to purchase common stock at the discretion of the Board of

GENERAL

CORPORATION



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Directors. The exercise price of incentive stock options may not be less than the fair market value of the common stock on the date of grant, while the exercise price of non-qualified stock options may not be less than 85% of the fair market value of the common stock on the date of grant. Generally, all options vest over a three year period.

The 1989 option activity is summarized as follows:

	Sha		
	Author- ized	Out- standing	Price
Authorized	250,000		
Granted	(86,000)	86,000	\$8.00-\$10.18
Balance at			
March 31, 1989	164,000	86,000	\$8.00-\$10.18

No options were exercisable as of March 31, 1989.

The Company has also established the 1989 Employee Stock Purchase Plan. Under the terms of the plan, employees may elect to withhold up to 10% of their compensation for the purchase of common stock. Amounts are withheld by the Company during a six-month offering period, and common stock is purchased at the end of the offering period at an offering price equal to 85% of the lesser of the fair market value of the shares on the first or last day of the offering period.

The Company has reserved 150,000 common shares for issuance under the plan. The first purchase of shares under the plan is scheduled for June 30, 1989.

In April 1989, the Company established the 1989 Outside Directors Stock Option Plan, whereby outside directors may be granted options to purchase common stock. 180,000 shares of common stock were reserved for issuance under this plan. All options are nonqualified stock options. Each existing outside director shall be granted an option of 30,000 shares on the effective date of the plan. Subsequent outside directors shall be granted an option of 30,000 shares upon election to the Board. Each outside director shall be granted an option of 5,000 shares each subsequent year on the anniversary date of the effective date or election date.

The exercise price of the stock option may not be less than the fair market value of the common stock on the date of the grant.

Generally, all options vest over a three year period.

8. INCOME TAXES:

The Company has elected early implementation of the Statement of Financial Accounting Standards No. 96 "Accounting For Income Taxes" for fiscal 1989 and 1988 in these financial statements. The components of the provision for income taxes for fiscal 1989 and 1988 consisted of the following (in thousands):

	1989	1988
Federal-		
Current payable	\$1,440	\$594
Deferred asset	(138)	(120)
	1,302	474
State-		
Current payable	405	154
	\$1,707	\$628

The sources of deferred tax assets were as follows (in thousands):

	1989	1988
Reserves and accruals not currently deductible for tax purposes	\$ 28	\$ 51
State taxes, not currently deductible for Federal tax purposes	81	57
Other	29	12
	\$138	\$120

The following is a reconciliation of the effective income tax rate for financial statement purposes to the United States statutory Federal income tax rate for fiscal 1989 and 1988:

	1989	1988
Statutory Federal income tax rate	34.0%	37.0%
State income taxes, net		
of Federal benefit	5.8	5.9
Other	.2	.1
	40.0%	43.0%



BOARD OF DIRECTORS

Harry J. Saal Chairman of the Board President and Chief Executive Officer

Leonard J. Shustek **Executive Vice President, Secretary**

Michael C. Child1 Partner, TA Associates

Gregory M. Gallo1 Member, Ware & Freidenrich

Laurence R. Hootnick 1 Senior Vice President, Intel Corporation

¹Member of Audit Committee

OFFICERS

Harry J. Saal Chairman of the Board President and Chief Executive Officer Director

Roger C. Ferguson Chief Operating Officer, Chief Financial Officer

Leonard J. Shustek Executive Vice President, Research and Development Director

George E. Comstock Vice President, Business Development

Morey R. Schapira Vice President, Sales

Legal Counsel Ware & Freidenrich Palo Alto, CA 94301

San Jose, CA 95110

Independent Public Accountants Arthur Andersen & Co.

The Sniffer is a trademark of Network General Corporation. All other registered and unregistered trademarks mentioned are the properties of their respective holders.

Inquiries Concerning Network General

If you have questions concerning Network General's operations, recent results, or historical performance, or if you wish to receive Network General's 1989 Annual Report, 1989 Form 10-K, or press releases, all of which are available without charge, please contact:

Investor Relations Network General Corporation 1945A Charleston Road Mountain View, CA 94043 415-965-1800

Inquiries Concerning the Stock

If you have questions concerning stock certificates, change of address, consolidation of accounts, transfer of ownership, or other stock account matters, please contact Network General's stock transfer agent:

Bank of America Stock Transfer Services P.O. Box 37002 Dept. 9527 San Francisco, CA 94137 415-624-4100

Common Stock

Network General's common stock is traded on the NASDAQ National Market System under the symbol NETG. As of June 1, 1989, there were 81 stockholders of record.

The high and low bid quotations for the fourth quarter 1989 (from February 2, 1989) were \$12.25 and \$8.00, respectively. These over-thecounter market quotations reflect inter-dealer prices, without retail mark-up, mark-down or commission and may not necessarily represent actual transactions.

Dividend Information

Network General has never declared cash dividends and presently intends to continue this policy.



NETWORK GENERAL CORPORATION 1945A Charleston Road Mountain View California 94043 415-965-1800